Minutes of the LIBOR Trade Association Working Party meeting

held on 17 July 2023

via Microsoft Teams

Present

ICMA
ICMSA
ISDA
LMA
LSTA

1. Introduction

The purpose of the meeting was for the trade associations to provide updates on any developments in respect of LIBOR transition since the last meeting.

2. LSTA update

In relation to US dollar LIBOR, the LSTA reported that the transition at end-June went well, with only a few companies having run out of time and some loans may have ended up transitioning to Prime as a result. The LSTA noted that the US domestic loan market saw a lot of fallbacks amendment transition activity in the weeks leading up to the discontinuation date for US dollar LIBOR. Virtually every loan adopted term SOFR plus a credit spread adjustment as a fallback.

Further, it was noted that a portion of loans are due to transition at the next interest period reset. This is in line with the general loan market's approach to LIBOR transition observed over the years, with transition efforts occurring towards the end of the transition timeline - probably thanks to the pressure added by the repeated warnings issued by global authorities.

3. LMA update

It was noted that the LMA held a meeting with its LIBOR Working Party last week and attended a meeting of the sterling Loan Enablers Task Force. During these meetings, no major issues in respect of US dollar LIBOR transition were reported. However, similar to what was reported by the LSTA, the transition activity was backloaded and some parties have opted to roll over their loans and will transition at the next interest period.

The LMA noted that there are a few operational issues that have arisen from the LIBOR transition. Particularly, the LMA has been made aware of issues with the application of fallbacks to compounded SOFR on certain US public holidays, such as on Good Friday. This is due to the different approach undertaken in LMA and LSTA / ISDA documentation. It was noted that the LMA had circulated a note to its LIBOR Working Party explaining these documentary differences as well the options available to help resolve the issue. The LMA will also discuss this issue with its Agency Documentation Committee later this week.

The LMA has also been dealing with the issue of cost of funds as a fallback. This arises mostly in term SOFR deals where parties have different views on the most appropriate fallback. Parties are not always keen to have fallbacks to compounded rates, probably because of a desire to avoid the additional complexities inherent with a compounded methodology (and the reasons why term SOFR was selected in the first place). It was noted that LMA documentation provides for a fallback to central bank rate (as an alternative to compounded), but the LMA has heard of there being some pushback on this due to certain bank internal policies. So, some deals have a primary fallback to cost of funds. The LMA has reiterated in its recent IBOR update webinar that cost of funds is not a robust and workable long-term fallback and, therefore, should not be selected as a primary fallback.

The LMA is also working on Term €STR switch documentation, which is currently being reviewed by the LIBOR Working Party. The LMA plans to publish it as an exposure draft as soon as practicable after an initial round of comments. It was highlighted that an increasing number of market participants are paying attention to the latest Euro Working Group's guidance based on the feedback and queries the LMA received from members.

Further, the LMA noted that the focus is now shifting towards other IBORs around the world with increasingly more questions being raised around these, as previously mentioned during the April meeting of this Working Group.

In relation to term SOFR, the LMA noted that global regulators have been consistent in their messaging on the permitted use cases for term SOFR. However, there remain issues in relation to hedging, and the LMA had received queries from members on hedging discrepancies. The LSTA noted that there were recent ARRC developments in relation to term SOFR hedging, which are designed to help alleviate this situation slightly.

ICMA asked whether the LMA could elaborate further on the Good Friday fallbacks to SOFR issue. The LMA explained that the issue arises in respect of fallbacks applicable to compounded SOFR in the LMA's recommended form compounded rate documentation in the event of certain US public holidays where SIFMA recommends an early close, but the Federal Reserve Bank of New York does not publish a rate for that day. This issue has arisen most recently on Good Friday. The LMA further explained that, if there is no SOFR published for an RFR Banking Day, LMA documentation envisages a fallback of the specified central bank rate plus an adjustment spread for that day, while LSTA and ISDA documentation use a historic SOFR as a fallback. ISDA noted that there are differences in how legal drafting deals with the non-publication of a rate on public holidays.

ISDA added that, following discussions with market participants, the ideal situation would be for SIFMA not to have an early close to release the employment data on those days. It was also noted that the economic impact of the difference is marginal. The LMA agreed that this issue has a very minimal economic impact, but some members had outlined concerns about the operational issues posed given that it required manual operational fixes if this was not identified prior to the event. ISDA noted that feedback from ISDA members suggest that the next time this holiday mismatch would create an issue would be 2026, supporting the point that this is a marginal issue. The LMA noted that some LMA members had requested whether it would be possible to align LMA documentation with ISDA / LSTA documentation. The LMA explained that this has the positive of creating alignment but the negative would be potential further confusion, as there will be a set of legacy contracts following one approach and new documents following another. The LMA thanked ISDA for sharing their views on the matter and noted that some LMA members had also recommended getting in touch with SIFMA to seek a common solution.

4. ICMA update

It was noted that ICMA is not aware of any significant problems arising from the US dollar panel bank LIBOR cessation on 30 June. ICMA is continuing to track consent solicitations of type 1 bonds which will fall back to a fixed rate on cessation of synthetic US dollar LIBOR on 30 September 2024. Not much activity has been observed in this respect so far, but ICMA will keep this under review.

Further, ICMA has just released a podcast in which Linklaters, Clifford Chance, Allen & Overy and Freshfields address the following: (i) what will happen / has happened with various types of fallbacks; (ii) consent solicitations; (iii) issues associated with securitisations; (iv) interaction of US dollar LIBOR, the LIBOR Act and any national legislation in terms of outcomes; and (v) any operational issues.

It was noted that ICMA had been made aware of some operational challenges arising from the fact that bond market participants are using different market conventions which are leading to discrepancies in payments on every interest payment date. Although the differences are marginal, they have the potential to become bigger and are already leading to operational strain because of the manual exercise required. ICMA is working with ICMSA on a possible solution to this using indexes. ICMSA noted that indexes should reduce the manual exercise needed, given that some of the problems are not linked to RFR implementation, but to rounding.

5. ICMSA update

ICMSA noted that the US dollar LIBOR transition on 30 June went well overall, as there were no reports of major issues or concerns. Most problems seem to be operations-related in respect of calendars and mismatches, such as drafting discrepancies in bonds and swaps documentation.

ICMSA observed a high level of activity in the market, and hopefully there will be more solicitation requests for type 1 bonds fallbacks in the coming months. For the time being, type 1 bonds holders will need to continue to seek quotations from banks.

Finally, ICMSA will continue to encourage market participants to transition to RFRs as soon as possible. It was added that the issues which have arisen from the US dollar LIBOR discontinuation seem to be specific to individual institutions rather than the wider market.

6. ISDA update

ISDA also had no major issues to report in respect of US dollar LIBOR transition. ISDA published a series of member Q&A webinars on US dollar LIBOR transition, which are available to watch on ISDA's benchmark hub. Further, it was noted that ISDA will monitor developments in the next few weeks and especially in the next interest rate period reset, when it is likely any issues will materialise (if at all).

The LMA asked whether ISDA was aware of other IBORs that are expected to be discontinued (other than the Canadian rate and the expected phase outs of the Polish and South African rates). The LMA noted that ISDA had previously mentioned the Israeli rate. It was noted that ISDA is in the process of updating its documentation tracking these developments and would send a follow-up email to the LMA once that has been done.

7. AOB

The LMA had been made aware by UK Finance of a small business loan complaint on LIBOR transition that was raised with the Financial Ombudsman. In holding that the bank had treated its customer fairly and acted within the RFR working group's guidelines, the reasoning behind the case is particularly useful in terms of LIBOR transition and fairness to customers.

The LMA thanked members of the Working Party for their contributions. The next meeting will take place in three months' time after the next interest rate reset.